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IN THE

Supreme Court of the United States

OCTOBER TERM, 1971

No. 71-845

MARTIN OIL SERVICE, INC.,

Petitioner,

vs.

ILLINOIS DEPARTMENT OF REVENUE,

Respondent.

BRIEF FOR RESPONDENT IN OPPOSITION

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BRIEF FOR RESPONDENT IN OPPOSITION

STATEMENT OF FACTS

Respondent disagrees in part with the Petitioner's Statement of Facts. It specifically disagrees with those self-serving portions relating to alleged requirements that Martin had to remit a federal gasoline tax on each gallon of gasoline *sold at retail*. Petitioner quotes 26 U.S.C. 4081(a) as creating that obligation. However, that section states:

> ". . . there is hereby imposed on gasoline sold by the producer or importer thereof, or any producer of gasoline, a tax of 4¢ per gallon."

The obvious purpose of Martin's insertion of the words "at retail" is to create an impression with this Court that Martin is in a special category because it is both a producer and a retailer. This is essentially a distinction without a difference, and was clearly found to be without merit by Mr. Justice Ward of the Illinois Supreme Court.

Martin further states (at page 4 of its Petition) that between 1935 and 1962, by reason of Regulations of the Department of Revenue of the State of Illinois, a retailer who was also a producer could deduct from gross receipts an amount equal to the gasoline tax that the retailer remitted to the Federal government; and, that on January 10, 1962, the Illinois Department of Revenue reversed its administrative construction. It should be noted that the Illinois Supreme Court held that the previous construction by the Department of Revenue was erroneous. (Petitioner's Brief and Appendix, 9-10).

A further omission of fact appears at page 5 of the Petitioner's Brief, where Martin states that:

> ". . . thereafter (it) ceased deducting federal gasoline tax in determining its 'gross receipts' . . . (and) paid the state tax as so computed into a protest fund."

Omitted is the finding of fact by the Illinois Supreme Court that the regulations were changed in 1962 and that "Martin undertook to persuade the Department to recall its amendment and while this effort was being made, that is, until April, 1964, *Martin itself absorbed the increased retailers' occupation tax* on all sales made through its retail outlets."

ARGUMENT

I.

THE DECISION OF THE ILLINOIS SUPREME COURT DOES NOT LACK INDEPENDENT AND ADEQUATE STATE SUBSTANTIVE GROUNDS TO SUPPORT THE JUDGMENT; NOR IS THERE A SUBSTANTIAL FEDERAL QUESTION PRESENTED IN THE DECISION.

The law is clear that this Court will decline to review state court judgments which rest on independent and adequate state substantive grounds, even where those judgments also decide federal questions. *Henry* v. *Mississippi*, 397 U.S. 443, 13 L. Ed. 2d 408, 85 S. Ct. 564 (1965). Additionally, this Court has gone so far as to say that it will not review a state court decision resting on an adequate and independent non-federal ground, even though a state court may have summoned to its support an erroneous view of the federal law. *Radio Station WOW* v. *Johnson*, 326 U.S. 120, 89 L. Ed. 2092, 65 S. Ct. 1475 (1944). The decision of the Illinois Supreme Court clearly rested on independent state grounds. Petitioners, however, attempt to raise an artificial issue when it alleges that the "non-federal ground is so interwoven with the other as not to be an independent matter."

Petitioners raised an issue of incidence of taxation which was foreclosed by the Illinois Supreme Court in 1934 in *People* v. *Werner*, 364 Ill. 594, 5 N.E. 2d 238 (1934). It is respectfully submitted that the incidence of federal taxation is irrelevant to the construction of the Illinois Retailers Occupation Tax, Sections 440, et seq. (Ch. 120, Sec. 440, et seq., Ill. Rev. Stat.) In reach-

ing its decision the Illinois Supreme Court clearly relied on *Fischmann & Sons* v. *Department of Revenue*, 12 Ill. 2d 253; 146 N.E. 2d 512 (1966), a case involving the construction of the Illinois Retailers Occupation Tax where the taxpayer was claiming a deduction for the Federal liquor tax.

Further it is clear that in Illinois no credit is permissible for Federal excise taxes. *Fischmann, supra; People* v. *Werner, supra.*

The discussion of the statutory construction of 26 U.S.C. 4081 et seq. is pure *judicial dicta.* The issue was raised by the Petitioner in its brief and argued orally but, as can be seen from the language of the decision, the discussion was not necessary for the disposition of the case. It is clear that the Illinois Supreme Court can rest upon *Fischmann, supra,* and *Werner, supra.*

It is a settled proposition of law in reviewing a judgment or decision of a state court that the record must show that the judgment rested alone upon the disposition of the federal question. *Marsh* v. *Nichols S. & Co.*, 140 U.S. 344 (1891); and further that the decision thereof was controlling in the disposition of the case. *Citizens Bank* v. *Board of Liquidation*, 98 U.S. 140, 25 L. Ed. 114 (1879). Additionally, jurisdiction of this Court cannot be founded upon a mere surmise that the decision of the state court rested upon the interpretation of a federal statute. *Lynch* v. *N. Y.*, 293 U.S. 592 (1934). It is submitted that Petitioner's request for Certiorari is insufficient on this ground.

Moreover, the Petition is insufficient on the ground that it raises an insubstantial and frivolous federal question, assuming that the discussion of 26 U.S.C. 4081 in the Illinois decision is something other than *judicial dicta.*

Seaboard Air Line R. Co. v. *Watson,* 287 U.S. 286 (1932). The alleged federal question presented by Martin is plainly insubstantial as its unsoundness results from previous decisions of this Court and is thus foreclosed.

California Water Serv. Co. v. *Redding,* 304 U.S. 252, 82 L. Ed. 1323, 58 S. Ct. 865; *Minneapolis, St. P. & S. Ste. M. R. Co.* v. *C. L. Merrick Co.,* 254 U.S. 376, 65 L. Ed. 312, 41 S. Ct. 142; *Leonard* v. *Vicksburg, S. & P. R. Co.,* 198 U.S. 416, 49 L. Ed. 1108, 25 S. Ct. 750.

As will be developed, the federal question presented by Martin is foreclosed by *Lash's Products Co.* v. *U. S.,* 278 U.S. 175, 49 S. Ct. 100, 73 L. Ed. 251, aff'g. 64 Ct. Cl, 252, and *Biddle* v. *Commissioner,* 302 U.S. 573, 581; 58 S. Ct. 379 (1937).

II.

THE INCIDENCE OF TAXATION FOR THE EXCISE TAX ON GASOLINE IS ON THE PRODUCER.

The statutory scheme of Federal excise taxes may be described generally as a heterogeneous group of taxes imposed on a variety of articles, products, services, facilities and transactions. They comprise a selective system of taxation and not a broad general plan of taxation. By selective system of taxation is meant that certain enumerated articles and services are taxed, and then only certain specific designated articles, services, products and transactions within the categories. For example, automobile equipment is taxed, however, the tax does not attach to all vehicles, but only to those of the highway type. 26 U.S.C. 4061, and Rev. Rul. 57-440 (CB 1957-2, 721). Also the tax does not attach to all electric, oil and gas appliances, but only to those of the household type. 26 U.S.C. 4121 and Rev. Rul. 58-49 (CB 1958-2, 788).

Likewise it is clear that only gasoline used on the highways was intended to be taxed. In effecting an element of tax on non-highway uses, a statutory scheme of refunds was implemented to non-highway users such as farmers. 26 U.S.C. 6421. Because farmers are entitled to refunds, however, it does not necessarily follow that Congress intended the gasoline tax to be a consumer tax. Rather Treasury Regulation 40.4081-1(a) manifests a clear intent that the liability be imposed upon the producer or distributor. The tax is on the producer, for the transaction, and not on the consumer.

III.

THE STATUTORY SCHEME OF CHAPTER 32 OF THE INTERNAL REVENUE CODE OF 1954 AND THE TREASURY REGULATION THEREUNDER CLEARLY REVEAL THAT THE TAX WAS NOT TO BE A CONSUMER TAX.

In an effort to ascertain the intent of Congress, the entire statutory scheme of federal excise taxation must necessarily be analysed and evaluated. In that scheme, the sections raised by Martin as comprising its federal statutory question are made part of Subchapter A of Chapter 32 of the Internal Revenue Code of 1954 (26 U.S.C. 4081-4084). Interestingly, Chapter 32 is entitled "Manufacturers Excise Taxes." These provisions are modified by Section 4216(b) of subchapter F of Chapter 32 (26 U.S.C. 4216(b)). Therein, Congress acknowledges that many manufacturers sell their products to wholesalers who, in turn, sell to the consumer. In many other cases, however, a manufacturer will sell directly to a retailer, and in others he (the manufacturer) will sell directly to

the consumer. Congress recognized that if a manufacturer sells directly to the consumer he would necessarily charge a greater sales price than if he sold directly to the wholesaler. Since the manufacturer-producer's taxes are based on selling price, the result would be that a higher tax would be imposed on sales to the consumer than would be imposed on sales to wholesalers. This, Congress thought, would create arbitrary price discrimination against the manufacturer-producer, and price him out of the market. Therefore, Congress, recognizing the desirability of imposing excise taxes on a uniform basis, enacted certain specific provisions designed to limit the taxes that could be imposed on the manufacturer and thus protect the manufacturer. Martin is a beneficiary of this relief.

Also, under Section 4216, the Treasury promulgated certain interpretative regulations regarding the computation of the offset credit allowable to gasoline manufacturers. These regulations were promulgated as Reg. 44 (1944) 314.0 et seq. These regulations are important inasmuch as they set out the regulatory scheme for the imposition of the gasoline taxes and the Treasury Department's interpretation of the statutes. These regulations appear under the 1954 Code as follows:

> Reg. 44 (1944), Sec. 314.0. **Scope of regulations.**—These regulations apply to the excise taxes imposed by Chapter 29, Subchapter A, of the [1939] Internal Revenue Code [now Chapter 32, Subchapter A] as amended, on sales of gasoline, lubricating oil, and matches. They deal with the determination of tax liability, the computation of the tax, the manner of its application, the collection and return of tax, the imposition of penalties, and related matters.
>
> * * * * * *

Reg. 44 (1944), Sec. 314.2. **Effective period.**—The taxes on the sale of gasoline, lubricating oils, and matches became effective under Title IV of the Revenue Act of 1932 on June 21, 1932. The applicable provisions of the Revenue Act of 1932 were superseded, effective March 1, 1939, by provisions of the [1939] Internal Revenue Code. [Reg. 44 (1944), Sec. 314.2.]

* * * * *

[¶1804] Reg. 44 (1944), Sec. 314.3. **Liability for tax.**—(a) Each manufacturer, producer, or importer is liable for tax on any sale, lease, or use of a taxable article, whether such sale, lease, or use is made directly or through an agent, except as otherwise provided. See Subpart C and sections 314.5, 314.32, 314.33, 314.42, and 314.43.

(b) The tax attaches upon sale or use by the manufacturer irrespective of when the article was manufactured, produced, or imported.

(c) In the case of a sale on credit, it is immaterial whether or not the purchase price is actually collected. [Reg. 44 (1944), Sec. 314.3.]

* * * * *

[¶1805] Reg. 44 (1944), Sec. 314.4. **When tax attaches.**—(a) In general, the tax attaches when the title to the article sold passes from the manufacturer to a purchaser.

(b) When title passes is dependent upon the intention of the parties as gathered from the contract of sale and the attendant circumstances. In the absence of expressed intention, the legal rules of presumption followed in the jurisdiction where the sale is made govern in determining when title passes. Generally, title passes upon delivery of the article to the purchaser or to a carrier for the purchaser.

(c) Where a manufacturer consigns articles to a dealer, retaining ownership in them until they are disposed of by the dealer, title does not pass and

> the tax does not attach until sale by the dealer. Likewise, where the relationship between a manufacturer and a dealer is that of principal and agent, title passes upon sale by the dealer, and tax thereupon attaches. [Reg. 44 (1944), Sec. 314.4.]

The 1939 Code Regulations were made applicable to the 1954 I.R.C. by T. D. 6091.

It is clear that the Treasury places the liability for the tax on the producer. No language is used in the regulations in any way to reflect that the Treasury views Martin or other producers as mere collecting agents for the U. S. Government. As pointed out by Mr. Justice Ward in his opinion "the statute does not impose any liability on the purchaser consumer if the gasoline tax is not remitted by the producer."

Furthermore, to support this line of thought, Congress has made it quite clear that the gasoline tax is assessable against the producer-retailer and not the consumer. 26 U.S.C. 6501. In the event that false returns are filed by a taxpayer-manufacturer, the Treasury Department has taken the view that the tax may be assessed at any time. Rev. Proc. 59-366 (CB 1952-2, 418). It would seem that if Congress intended the gasoline tax to be a consumer tax, the Internal Revenue Code would contain provisions for assessing the tax against the taxpayer-consumer. But it does not.

IV.

THE COURTS HAVE HELD THAT TAXES IMPOSED BY CHAPTER 32 OF THE INTERNAL REVENUE CODE OF 1954 ARE PRODUCER TAXES.

Martin, nevertheless, would have this Court believe that the incidence of taxation rests upon the consumer in

citing *Standard Oil Co. of Indiana* v. *State Tax Commissioner*, 71 N.D. 146; 299 N.W. 477 (1941) and *Standard Oil* v. *State*, 283 Mich. 85, 276 N.W. 908 (1937). As pointed out by Mr. Justice Ward of the Illinois Supreme Court, neither of these cases involves the incidence of taxation.

This Court need not rely upon mere conjecture as to the intent of Congress. The law is clear that the Manufacturers Excise Tax is imposed on the manufacturer alone. In *Lash's Products Co.* v. *U. S.*, 278 U.S. 175, 176, Mr. Justice Holmes characterized the excise tax imposed on "soft drinks" as:

> "This is a suit to recover the amount of certain taxes paid under the Revenue Act of 1918 (Act of February 24, 1919, chap. 18, § 628, 40 Stat. at L. 1057, 1116). By § 628 there is imposed on 'soft drinks, sold by the manufacturer, . . . in bottles or other closed containers, a tax equivalent to 10 per centum of the price for which so sold.' This tax was paid by the petitioner, calculated at 10 per centum of the sum actually received by it for the goods sold. But the petitioner had notified its customers beforehand that it [176] paid the 10 per cent tax, and it contends that in this way it passed the tax on, and that the true price of the goods was the sum received less the amount of the tax. *The phrase 'passed the tax on' is inaccurate, as obviously the tax is laid and remains on the manufacturer and on him alone. Heckman & Co.* v. *L. S. Dawes & Son Co.*, 56 App. D.C. 213, 12 F. (2d) 154. The purchaser does not pay the tax. He pays or may pay the seller more for the goods because of the seller's obligation, but that is all. Still the question as to the meaning of the statute remains." (Emphasis added).

Likewise, in *Shearer* v. *Commissioner of Internal Revenue*, 48 F. 2d 552, 554, 555, Mr. Justice Learned Hand, in in-

terpreting another provision of what is now Chapter 32 of the Internal Revenue Code of 1954, stated:

> "*As to the second point, the motor tax is imposed upon the dealer, not the purchaser,* Section 900 (42 Stat. 291) levies an excise upon 'the following articles sold . . . by the manufacturer,' and if it had been theoretically open to argument whether the dealer or the buyer was the subject of the tax, the question was set at rest by *Lash's Products Co.* v. *U. S.*, 178 U.S. 175, 49 S. Ct. 100, 73 L. Ed. 251. In that case a similar tax under section 628 of the Act of 1918 (40 Stat. 1116) was held to be imposed upon the dealer, and to be part of the purchase price upon which the percentage should be computed, though this results in taxing the tax itself when it has been 'passed on' to the customer." (Emphasis added).

Another case on *all fours* with the instant matter is *Sun Oil Co.* v. *Gross Income Tax Commission of Indiana*, 149 N.E. 2d 115, 58 USTC, Par. 15145, 238 Ind. 111 (1958).

Petitioner, however, would suggest to this Court that *Tax Review Board of Philadelphia* v. *Esso Standard Division of Humble Oil and Ref. Co.*, 424 Penn. 355, 227 A. 2d 657, correctly states the law.

It is respectfully submitted that the petitioner and the Supreme Court of Pennsylvania both indulge in *post hoc ergo proctor hoc* reasoning. Because the petitioner and others have the ability to pass the tax on to the consumer, it does not necessarily follow that the gas tax was intended by Congress to be a consumer tax. Federal cases and common sense point to the opposite conclusion.